No. 20086

(A companion case to No. 20085)

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

EMMA M. HEBER AND ESTATE OF HENRY D. HEBER, Deceased, EMMA M. HEBER, Administratrix,

Petitioner and Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent and Appellee.

Appeal From the Tax Court of the United States.

APPELLANT'S OPENING BRIEF

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STATEMENT DISCLOSING BASIS OF JURISDICTION OF THE TAX COURT AND OF THE COURT OF APPEALS FOR THE NINTH CIRCUIT AND BRIEF SUMMARY OF FACTS AND ISSUES.

The Petitioner (the Appellant) is an individual taxpayer residing in the City of South Pasadena, California. In the Tax Court proceeding and in this Appeal Petitioner represents herself in her individual capacity and as

Administratrix of the Estate of Henry D. Heber, deceased, her late husband.

Petitioner, Emma M. Heber, and her late husband, Henry D. Heber, filed timely, joint, cash basis personal income tax returns for the calendar years 1956, 1957 and 1958 (the years here involved) with the District Director of Internal Revenue at Los Angeles, California, and paid to the said District Director the tax called for by the said returns. The District Director of Internal Revenue at Los Angeles, California and the Collection District administered by him is within the jurisdiction of the United States Court of Appeals for the Ninth Circuit. The taxpayer's Petition to the Tax Court of the United States [Tr. Vol. I Document No. 7, p. 20-29] and Petition for Review [Tr. Vol. I Document No. 34, p. 104-112] set out all of the pertinent jurisdictional allegations.

Relationship of This Appeal With the Companion Case of Commissioner of Internal Revenue, Petitioner, vs. Lillian E. Yaeger, Respondent, No. 20085.

The instant appeal was consolidated for trial before the Tax Court of the United States with the case of *Lillian E. Yaeger vs. Commissioner of Internal Revenue,* T.C. Docket No. 4496-62. The two cases involve deficiencies in personal income tax. The Commissioner of Internal Revenue has taken diametrically opposed positions in the two cases, both before the Tax Court of the United States and in these Appeals which come on together for hearing before the United States Court of Appeals for the Ninth Circuit.

Statement of Issues.

This case involves a deficiency in personal income taxes for the calendar years 1956, 1957 and 1958 in the respective amounts of $291.24, $7,797.50 and $741.56 [Tr. Vol. I Document No. 29, p. 96]. The case was heard before the Honorable William M. Fay, Judge of the Tax Court of the United States at Los Angeles, California on December 2, 1963. The Tax Court had jurisdiction over the issues by virtue of 26 U.S.C.A. § 7442 et. seq. The Tax Court entered its Decision on December 2, 1964, ordering and deciding that there was a deficiency in income tax of Petitioner as above indicated. This Court has jurisdiction to review on appeal the Decision of the Tax Court of the United States by virtue of Section 7482 and 7483 of the Internal Revenue Code of 1954 (26 U.S.C.A. §§7482 and 7483).

The issues before this Court are whether there was error in the Tax Court's Decision in — (a) *Heber et al vs. Commissioner* [T.C. Docket No. 4543-62], that there was an aggregate deficiency in personal income taxes in the amount of $8,830.30 for the reason that amounts received by Petitioner Heber during the years in question were not properly capital gain as treated by Petitioner Heber but should be reported by her and her late husband as ordinary income; or whether in (b) *Yaeger vs. Commissioner* [T.C. Docket No. 4496-62], there should have been an aggregate deficiency of $14,109.04 [Tr. Vol. I p. 9] for the reason that amounts paid by Lillian E. Yaeger to Petitioner Heber were there treated as a

division of income rather than capital payments for the acquisition of a capital asset.

Statement of Facts.

Petitioner Heber and her late husband were individual taxpayers residing in the City of South Pasadena, State of California. They were married in June of 1947 [Tr. Vol. II Tax Court Transcript p. 73] and Mr. Heber passed away July 29, 1962 [Tr. Vol. II Tax Court Transcript p. 73]. Petitioner Emma M. Heber is a registered nurse [Tr. Vol. II Tax Court Transcript p. 73].

On September 2, 1939, Petitioner Heber entered into a partnership agreement with Lillian E. Yaeger, under the terms of which they acknowledged that they were the equal owners of certain real properties described therein as Parcels 1 and 2; that they intended to acquire additional properties in which they were to have an equal interest; that they were to own and operate these and other properties as equal partners; that should either partner become dissatisfied, or desire to withdraw, that such partner should not be permitted to do so before making an offer to either sell to the other, or purchase the undivided one-half interest in the fee ownership of properties fully owned by the other party; and that in the event no sale occurred within a period of thirty days, then the partnership was to be dissolved by operation of law. (Joint Exhibit 8-H). After execution of the said partnership agreement on September 2, 1939, the partnership acquired a liquor store and additional properties designated as Parcels 3, 4, 5 and 6 which were vacant lots, and Parcel 7, a ranch property which was acquired

in January or February of the year 1944 [Tr. Vol. II Tax Court Transcript p. 80]. All of the said properties are described in a document designated "Agreement" dated August 10, 1944 (Joint Exhibit 9-I).

The said document captioned "Agreement", dated August 10, 1944 (Joint Exhibit 9-I), is a written dissolution of the partnership, calling for conveyances, the result of which was to place the fee simple title to all of said parcels in Lillian E. Yaeger and divest Petitioner Heber of any interest therein. The consideration for such transfers is said to be "a life interest in and to one-half of the rents, issues and profits for and during the period of her natural life". Petitioner Heber accepts the position that the said document captioned "Agreement" dated August 10, 1944 (Joint Exhibit 9-I) dissolved the existing partnership and is the basic instrument which purports to fix the present rights of the parties. Under it payments have, from time to time, been made, the nature of which is the principal issue in these two cases. Petitioner Heber does not accept the proposition that said document is in fact an "agreement", or that she can be bound by any of its descriptive terms or any of the language used therein. This is because the said document was prepared by Lillian E. Yaeger's attorney without the knowledge of Petitioner Heber, and because Petitioner Heber was coerced into signing the said document without having read it, and without the benefit of counsel, and at a time when she, Petitioner Heber, was ill. [Tr. Vol. II Tax Court Transcript p. 79].

After the signing of the said document (Joint Exhibit 9-I) on August 10, 1944, Parcels 3, 4, 5 and 6 were sold

by Lillian E. Yaeger, along with the liquor store, and the proceeds of such sales all went to reduce the mortgages on the other properties acquired and then owned by Yaeger. No benefit inured to Petitioner Heber as a result of these sales [Tr. Vol. II Tax Court Transcript p. 57 and p. 70]. Petitioner Heber received only small and spasmodic payments on her "life income" [Tr. Vol. II Tax Court Transcript p. 50], and they ceased entirely from 1948 through the year 1953 [Tr. Vol. II Tax Court Transcript p. 86].

For some time after the document of August 10, 1944 (Joint Exhibit 9-I) Lillian E. Yaeger endeavored to charge to Petitioner Heber depreciation, a manager's salary and other improper items, and co-mingled funds from the properties with other funds. See *Steeve vs. Yaeger,* 145 Cal.App.2d 455, 30 P2d 704. The aforesaid litigation, i.e. *Steeve vs. Yaeger,* was instituted by Petitioner Heber (her name being Steeve before her marriage to her late husband) when she become discouraged with the attitude and delinquencies of Lillian E. Yaeger. As a result of said litigation, and a judgment in favor of Petitioner Heber, Yaeger was required to make and did make large payments to Petitioner Heber in the years here in question.

From and after the critical date of August 10, 1944 until 1947, personal income tax returns were prepared for both Petitioner Heber and Yaeger by a Mr. Hawk, public accountant, who later associated Mr. Stoy, the present auditor and accountant for Yaeger [Tr. Vol. II Tax Court Transcript p. 29]. Mr. Hawk and Mr. Stoy determined Petitioner Heber's methods of report-

ing payments received from Yaeger and established the pattern therefor until Heber ultimately obtained independent advice [Tr. Vol. II Tax Court Transcript p. 30 and pp. 81-82].

The Respondent Commissioner of Internal Revenue is in agreement with Petitioner Heber that if there was a sale or exchange of a capital asset (i.e. a partnership interest or fee ownership of real properties) for a consideration consisting of a different thing of value or bundle of rights, i.e. a life income, then the payments in question were reportable by Petitioner Heber as a capital gain and not deductible upon the income tax returns of Lillian E. Yaeger [Tr. Vol. II Tax Court Transcript p. 14]. This is the issue in the instant appeal.

SPECIFICATION OF ERRORS.

The Tax Court erred —

(1) In not determining whether the Agreement of August 10, 1944 constituted a sale or exchange under the provisions of Section 117 et seq of the Internal Revenue Code of 1939 (Section 1201 et seq of the Internal Revenue Code of 1954);

(2) In finding specifically that Petitioner Heber must report as ordinary income, payments received by her as an income for life, irrespective of whether such payments constituted consideration for the sale or exchange of a capital asset, or whether such life income was paid and received as a liquidating distribution of partnership assets;

(3) In not determining the then fair market value of the life income or life estate as of the date of execution

of the "Agreement" of August 10, 1944, and in further not determining Petitioner Heber's cost or basis of her interest in the partnership;

(4) In not determining that a partner's ownership interest in a partnership, the assets of which constitute real property, constitutes in the hands of the partner a capital asset, and in further not determining whether or not the sale or exchange, or liquidating distribution, of such capital asset results in a sale or exchange giving rise to capital gain or loss under the provisions of Section 117 et seq. of the Internal Revenue Code of 1939 (Section 1201 et seq of the Internal Revenue Code of 1954);

(5) In not determining that the income tax returns filed by Petitioner Heber and her late husband for the years 1956, 1957 and 1958, as amended, were correct in theory;

(6) In determining that there are deficiencies in income tax due from Petitioner Heber for the said taxable years 1956, 1957 and 1958; and

(7) In that its Opinion, Decision and Computation of Tax for Entry of Decision are contrary to law and are not supported by the evidence.

ARGUMENT.

Undisputed Basic Realities.

Certain undisputed facts and circumstances surrounding the relationship of Petitioner Heber and Lillian E. Yaeger, the basic document of August 10, 1944 (Joint Exhibit 9-I) and the true significance of certain trans-

actions and events must be briefly established and understood. These are numbered for brevity and emphasis:

(1) On September 2, 1939 when the "Co-partnership Agreement" was executed (Joint Exhibit 8-H) Petitioner Heber was the owner of a full and unrestricted one-half interest in the partnership and in the partnership assets composed of various parcels of real property. This interest and these assets in the hands of Petitioner Heber constituted a capital asset. (Internal Revenue Code of 1939, Section 117(a) et seq, 26 U.S.C.A. Int. Rev. Code § 117(a) et seq).

(2) The above position of unrestricted ownership of a capital asset or assets continued without change until execution of the document designated "Agreement" on August 10, 1944 (Joint Exhibit 9-I).

(3) On August 10, 1944, Petitioner Heber was compelled to transfer, assign and convey her ownership interest in the partnership and partnership assets consisting of real property to Lillian E. Yaeger. The partnership was thereupon terminated. [Tr. Vol. I p. 68 — T. C. Memo Facts and Opinion, p. 19]. There was not only a conveyance of real properties but a change in the relationship from that of partners to that of fiduciary and beneficiary. "The interests which Heber and Yaeger received in the former partnership properties were substantially altered after the execution of the termination agreement, as were the relationship between Heber and Yaeger and the manner in which the properties were operated and maintained." [Tr. Vol. I p. 68 — T.C. Memo Facts and Opinion, p. 19].

(4) Thus Petitioner Heber on August 10, 1944 exchanged, conveyed and parted with a capital asset or assets, whether voluntarily or involuntarily, and at the same time received in exchange or in consideration thereof a bundle of rights or thing of value, i.e. a life interest in the income of certain properties or the proceeds therefrom, after investment and reinvestment, which properties and values were thenceforth to be wholly owned and exclusively operated by another person, i.e. Lillian E. Yaeger [Tr. Vol. I p. 67 — T.C. Memo Facts and Opinion, p. 18].

(5) The sale or exchange and transfer and acceptance of consideration from and between Petitioner Heber and Yaeger was fully accomplished and completed, its tax significance established, and values became determinable for tax purposes on the said critical date of August 10, 1944.

(6) The facts hereinabove recited, and the sole and only issue with respect to such facts, were stipulated and agreed to by and between Counsel for Petitioner Heber and Counsel for the Respondent Commissioner of Internal Revenue and the Honorable William M. Fay, Judge of the Tax Court of the United States, at the time of trial. See the following statement of the issue and stipulation with respect thereto in open court:

> "Mr. Rhodes: (counsel for Respondent Commissioner of Internal Revenue) If a sale did occur in 1944 the payments made by Miss Yaeger to Mrs. Heber would simply be consideration for the sale of a capital asset, that this would be capital gains, but

in that event Miss Yaeger would be taxable on the entire income from the property.

"The Court: I thought that I possibly misunderstood you, but I did not.

"Mr. Rhodes: That is all, yes.

"The Court: I assume that that is the law, if a sale did occur in 1944 and these are payments then obviously they would be capital gains to the recipient. I do not think there could be any dispute about that.

"Mr. Little: (counsel for Petitioner Heber) No, that is the issue, Your Honor."

(7) The Tax Court of the United States did not decide this issue; it ignored the stipulation of Counsel for Petitioner and Respondent; it did not determine the cost or basis of the capital assets exchanged in the hands of Petitioner Heber, nor did it attempt to establish the valuation of the consideration received by her on August 10, 1944; and it decided the case arbitrarily, erroneously and illegally upon an irrelevant theory of its own not encompassed in or raised by the pleadings or Counsel. [Tr. Vol. I p. 70 — T.C. Memo Facts and Opinion, p. 21].

Sale or Exchange of A Capital Asset in Consideration of A Wholly Different Bundle of Rights or Thing of Value.

Petitioner Heber was and is a nurse [Tr. Vol. II Tax Court Transcript, p. 73]. Lillian E. Yaeger was and is a real estate broker [Tr. Vol. II Tax Court Transcript p.

43]. Petitioner Heber and Yaeger were the owners in fee of an undivided one-half interest in certain real property constituting a capital asset on September 2, 1939 (Joint Exhibit 8-H). On August 10, 1944 an "Agreement" was entered into (Joint Exhibit 9-I) which immediately and effectively dissolved the partnership:

> "Upon an examination of all the facts before us, it is clear that after the execution of the termination agreement and the various deeds mentioned therein, Heber, in lieu of her partnership interest, was left with a life estate in an undivided one-half of the former partnership properties. In lieu of her partnership interest, Yaeger received (1), as a tenant in common with Heber, a present interest in the Fullerton properties, namely a life estate, measured by Heber's life, in an undivided one-half of the properties; plus (2) a future interest, namely the entire fee interest therein upon Heber's death" [Tr. Vol. I pp. 69 and 70 — T.C. Memo Facts and Opinion, pp. 20 and 21].

It is believed that the above quote from the Tax Court's Opinion is significant wherein it recognized that "in lieu of her partnership interest" Petitioner Heber received a life estate in income. A life estate in income, whether it stems from certain identifiable properties, or the proceeds therefrom, is certainly a different thing of different value than an outright ownership of the said properties. On August 10, 1944 there was a significant economic change of position. A taxable event occurred at that time. Lillian E. Yaeger was substantially enriched (Note: If the theory of the Tax Court were to be ac-

cepted this enrichment should have been taxed to Yaeger on August 10, 1944 as a result of her "bargain"), and Petitioner Heber was involuntarily compelled to accept, in exchange for a capital asset, an entirely different thing of lesser but determinable value.

One error made by the Tax Court was to attribute to the "Agreement" of August 10, 1944 (Joint Exhibit 9-I) the aspects of a bona fide arm's length agreement or bargain and sale, and to attempt to bind the respective parties by what was said therein. In its Findings and Opinion the Tax Court was obviously aware of the relationship between the parties and the realities of the situation as may be seen by some of its statements:

> "Thereafter, Yaeger ceased paying any monies to Heber (referring to the date of January 1, 1948) with respect to her interest in the Fullerton properties, but began to pay herself $200 per month as a manager's salary, charging this amount against the rental income produced by the Fullerton properties." [Tr. Vol. I p. 58 — T.C. Memo Facts and Opinion, p. 9].

> "At best, their joint ownership of the Fullerton properties could most adequately be described by that term coined by Roman jurists, a Societas Leonina[3]."

> 3 "This epithet is an allusion to the fable of the lion who, after entering into a partnership with the other wild beasts for hunting, appropriated the whole prey to himself."

[Tr. Vol. I p. 67 — T.C. Memo Facts and Opinion, p. 18]. The Findings and Opinion of the Tax Court on the subject of the so-called "Agreement" (Joint Exhibit 9-I)

are inconsistent and foggy. The Tax Court finds as a fact [Tr. Vol. I p. 54 — T.C. Memo Facts and Opinion, p. 5] "All of the properties of the partnership were managed solely by Yaeger. Heber did not participate in the management thereof". This reference is to the existence of the partnership between the date of the beginning thereof on September 2, 1939 and the termination thereof on August 10, 1944. Then a few pages later [Tr. Vol. I p. 57 — T.C. Memo Facts and Opinion, p. 8] the Tax Court undertakes to interpret the motives of Lillian E. Yaeger (wholly unnecessary and uncalled for) by finding further as follows:

> "Yaeger's purpose in causing Heber to execute the termination agreement was to reshuffle their interests in the partnership properties in order to reflect the fact that Heber, because of illness, had become unable to assist Yaeger in any of the affairs of the partnership".

The Tax Court had already found that Petitioner Heber never did assist Yaeger in the partnership affairs. Her partnership interest and ownership of partnership assets resulted from substantial cash contributions for the purchase thereof, which amounts appear on the amended returns in question as her cost for the capital assets sold. Petitioner's Heber's cost or basis for these capital assets has not been raised by Respondent as an issue.

The point to be made here is that with respect to the critical "Agreement" of August 10, 1944 Petitioner Heber cannot be bound by any of the language used therein nor any of the terms thereof. The said "Agree-

ment" was executed by Petitioner Heber under duress, without counsel, at a time when she was ill, and the said "Agreement" was prepared for her signature and she was required to sign the same by Yaeger and Yaeger's attorney [Tr. Vol. II Tax Court Transcript, p. 79]. Any attempt therefore by the Tax Court to attribute legal significance to the said "Agreement" or to interpret the said "Agreement", as far as Petitioner Heber is concerned, is legally and morally wrong. The Tax Court must be guided solely by the economic realities of what transpired.

Analysis of Petitioner Heber's Substantive Position and Applicable Legal Precedents — Analogy to Involuntary Conversion.

As has been shown and established Petitioner Heber, through the execution and recording of formal grant deed conveyances, fully divested herself of an outright ownership in real properties. (Joint Exhibits 10-J, 11-K and 13-M). One of the principal questions to be decided is whether or not a sale or exchange took place on August 10, 1944 at the time of the so-called "Agreement" and the execution and recordation of the said conveyances. A related question or companion question is whether or not this substantial change of economic position and the exchange of a capital asset or assets, i.e. a partnership interest or the underlying real properties involved, constituted an incident or event having at the time taxable significance.

In reading a multitude of cases and commentaries on this general subject, one frequently finds that decisions

turn on issues of motivation, sound business reason or frivolous transactions whose sole object is tax avoidance. Here, as is plainly apparent, there was no bargain or sale in that there was any meeting of the minds or voluntary negotiation, since Petitioner Heber was coerced into her actions by highhanded methods and the domineering insistence of Yaeger. However, having been so mistreated, Petitioner Heber can certainly not be denied any redeeming tax advantages to which the realities might entitle her. An analogy might be drawn here to the cases having to do with involuntary conversions, which it is uniformly held result in capital gains or losses (*Commr. v. Peterman, et al.,* 118 F2d 973 (C.A. 9 1941).

Analogy to An Annuity.

If the motivations and intentions of either of the parties with respect to the August 10, 1944 "Agreement" are controlling, and if such intentions and motivations are to be resorted to in interpreting the "Agreement" (and it is submitted that they should be), these would certainly have to be the intentions and motivations as expressed by Lillian E. Yaeger. Petitioner Heber had no hand in drafting the "Agreement" and was compelled to sign it against her wishes and, therefore, cannot be bound by its terms.

At the Tax Court trial Lillian E. Yaeger was asked both on direct and cross-examination what her intentions were on August 10, 1944 with respect to Petitioner Heber as follows:

"Q: (by Mr. Dodge, Counsel for Yaeger) What was the agreement between you and Mrs. Heber, and

why was it entered into, concerning the division of the properties at August 10, 1944?

A: Well she was ill and I wanted to give her an income for the rest of her life."

[Tr. Vol. II Tax Court Transcript, p. 50]; and

"Q: (by Mr. Little, Counsel for Petitioner Heber) Now, Miss Yaeger, I am almost through here. With reference to the document dated August 10, 1944, you say this was executed at the time when Mrs. Heber was ill?

A: That's right.

Q: I note in the Agreement that it provides that in the event of illness of the parties, and the income is not adequate, that the properties may be invaded to take care of them.

A: That's true.

Q: I believe that you stated that in view of the fact that she was ill you wanted to see her have an income for life, is that right?

A: I did, yes sir.

Q: Did you insert this reference to medical care into the Agreement again having in mind her illness and —

A: Whatever the contract says.

Q: Yes. Who prepared this document of August 10, 1944?

A: Our attorney.

Q: Now you say 'our attorney,' —

A: Yes sir.

Q: — Who is that?

A: Mr. Harvey." (Yaeger's personal attorney).

[Tr. Vol. II Tax Court Transcript, pp. 60 and 61].

In determining whether or not there has been a taxable sale or exchange of a capital asset, or merely an inconclusive or tax-motivated rearrangement of the interests of the parties without tax significance, it is necessary to determine whether or not the so-called "seller" divested herself of a tangible capital asset in exchange or consideration for some other or different thing of value, i.e. a different bundle of rights or a different property value. Here we clearly see that it was the motive and intention of Yaeger, respectively submitted to be the only motive or intention to which we can look, that she with maternalistic beneficence intended to give, in exchange for conveyance of title to real properties, an "income for life", and Yaeger and her attorney even added to this annuity-like consideration medical benefits with provisions for invasion of the corpus if Petitioner Heber were to fall ill and monies from the properties were not available. This further clearly shows that income from the properties was not looked to as the sole source of amounts to be payable to Petitioner Heber.

The Tax Court made no effort to determine the value of this annuity-like promise of an income for life (if its value could be determined) and made no effort to determine what the enrichment of Lillian E. Yaeger might have been as a result of this sale or exchange, or what the impoverishment or loss of Petitioner Heber

might have been as a result thereof. The consideration and the values of identifiable assets flowing from one party to the other were obviously dispropriate and not of like kind.

Analysis of the Problem From the Standpoint of An Identical Transfer and Exchange of Considerations, If The Same Were to Occur Between Unrelated Parties, Rather Than Related Principals.

We find the following commentary in Merten's Law of Federal Income Taxation, Volume 3 B, Section 22:98, Page 404:

"In the reasoning found in support of these decisions the courts have sometimes pointed to the circumstance that if the particular item, such as a lease or a contract, had been sold to a third party instead of being released to the other party to the arrangement the gain derived therefrom would have been capital gain.[11] The opinion was then expressed that no different result should follow in the case of a release. The conclusion that the two types of situations should not have different tax consequences is sound, but places in question the results reached in earlier cases which inconsistently found a sale or exchange to be missing where there was a release or compromise of debt. In the effort to reconcile other cases, comment is made in some of the cases that the release pertained to or affected physical property where capital gain treatment was allowed.[12]

11 Comm. v. McCue Bros. and Drummond Inc., 210 F2d 752 (C.A. 2d, 1954) Cert. den. 348 U.S. 829, and other citations.

12 Comm. v. Starr Bros., Inc., 204 F2d 673 (C.A. 2d, 1953); Comm. v. Goff, 212 F2d 875 (C.A. 3d, 1954), cert, den 348 U.S. 829."

In viewing the relationship between the parties involved in this Appeal, and particularly from the standpoint of Petitioner Heber, the above test would certainly seem a logical way to approach the problem. If the "Third Party Test" should be the law, the ultimate conclusion could hardly be in any doubt.

Let us assume for the moment that Petitioner Heber in August of 1944 were to approach a third party stranger and represent to that stranger that she was the owner of record of an undivided one-half interest in certain real properties. Let us then assume that Heber were to propose to this third party stranger that she would convey outright title, without any strings attached, to her interest in the said real properties in exchange for or in consideration of one-half of the income therefrom for life, plus the provision that in the event of her illness and income was not sufficient, the corpus or principal, or other funds, would be invaded to assure the lifetime income and security of Petitioner Heber. Could there then be any doubt that there was a sale or exchange of capital assets giving rise to a capital gain? And is there any logical reason why the instant situation should not be viewed in the same manner?

Monies Received by Petitioner Heber Not Attributable to Identifiable Assets Solely — Analogy to A Trust.

The basic document of August 10, 1944, as hereinabove stressed, provides for the payment of medical expenses of Petitioner Heber out of "principal" or "corpus" in the event of her illness, should income from the properties be insufficient for such care. The Court,

in the case of *Steeve vs. Yaeger,* 145 C.A.2d 455 at pages 464 and 465, found and held that Petitioner Heber was entitled to medical expenses to be paid out of corpus; and the Court further found that there was a "confidential relationship between the parties" and that Yaeger had co-mingled income from the properties and used portions thereof for her personal expenses. These facts and the determinations tend to support a theory that Petitioner Heber's position, whatever it may elsewhere and otherwise be designated, was comparable to that of a beneficiary under a trust, and that under a fiduciary relationship Yaeger was required to make payments to her and care for her. This is in accord with Yaeger's own testimony at the Tax Court hearing [Tr. Vol. II Tax Court Transcript pp. 60 and 61] and tends to support the trust or annuity theory, since the obligations of Yaeger go beyond identifiable assets, and the specific income therefrom. It should be noted that Yaeger had absolute control and ownership of all of the assets involved. It should also be noted that some of the properties conveyed by Petitioner Heber to Yaeger were not income producing properties but were in fact investment properties to be indefinitely owned and held by Yaeger. This is true of the most valuable piece of property of all, namely Parcel 7 or the so-called ranch property [Tr. Vol. II Tax Court Transcript p. 48], and some of the properties conveyed by Petitioner Heber to Yaeger were promptly sold, and the proceeds thereof went to reduce mortgages on other properties, including non-income producing investment properties, then solely owned by Yaeger. [Tr. Vol. II Tax Court Transcript p. 70].

Sale or Exchange Giving Rise to Capital Gain or Loss.

A basic contention of Petitioner Heber, stipulated to by Respondent, and one which the Tax Court erroneously failed to consider or decide, is that on the critical date of August 10, 1944 there was a sale or exchange of a capital asset giving rise at that time to the recognition of capital gain or loss. That Petitioner Heber's partnership interest, or her absolute ownership of an undivided one-half interest in the underlying real properties, constitutes a capital asset under the then prevailing law, can be in no doubt whatever. (Internal Revenue Code of 1939, Section 117(a), 26 U.S.C.A. Int. Rev. Code § 117(a); and Regs. 111 Sec. 29.117 et seq.). Nor can there be any doubt that under the applicable law and decided cases, disposition of such capital assets under the facts in the instant case constituted a sale or exchange of capital assets, giving rise to taxable capital gain or loss. See *U.S. v. Adamson,* et al, 161 F2d 942, (C.A. 9 1947). In that case the Appellate Court quoted with approval the following comments of the United States District Court:

> "The Court: It seems to me that the Stilgenbaur case (9 Cir., 115 F2d 283) is binding, in the light of the stipulation of facts and in the light of the agreement which was entered into in this case. That decision holds that any method of terminating the partnership, whether it be by mutual agreement dissolving the partnership and a withdrawal of capital by one partner, or whether it be sold to outsiders, or whether it be by the legal process of dissolution, any one of these is treated by the Ninth Circuit as a sale, and taxable as capital loss or gain, and not as income.

For that reason, the judgment should be for the plaintiff, and it will be so ordered."

In the instant case there was no conversion or anticipation of accrued profit or future income, and Petitioner Heber certainly had no such intention or motive. Petitioner Heber was compelled to do what she did but the substantive realities of the transaction were the receipt of a present consideration by her (security for life without the burdens of ownership) in exchange for existing ownership and all of the benefits and burdens inherent in the ownership of real property.

The Tax Court's Irrelevant Theories and Wrongful Conclusions.

The Tax Court in its Opinion (Tr. Vol. I pp. 70 and 71, T.C. Memo Facts and Opinion, pp. 21 and 22) stated as follows:

"Therefore, whether we conclude (1) that Heber sold her partnership interest to Yaeger in return for a life estate in an undivided one-half of the Fullerton properties or (2) that Heber received said life estate as a liquidating distribution, in kind, upon the dissolution and termination of the partnership, Heber, nevertheless, must report, as ordnary income (reduced by any available deductions for amortization or depreciation), her 50 per cent share of the net rental produced by said properties and attributable to her life estate therein."

First, the Tax Court overlooks and ignores the pleadings in this case and the stipulation between Counsel for

Petitioner Heber and Counsel for Respondent establishing that the issue to be decided was whether or not there was a sale. The cases of *Bernstein vs. U.S.*, 253 F2d 19 (C.A. Mo. 1956) and *Berry vs. Commr.*, 254 F2d 471 (C.A. 9 1958) hold that stipulations entered into by the parties are binding and conclusive and the courts are required to enforce the same, and that such stipulations by counsel cannot be disregarded in the Appellate Courts.

Secondly, the Tax Court's Opinion is erroneous as a matter of law and the Tax Court fails to make necessary findings and determinations because of its irrelevant theory.

There was a sale or exchange on August 10, 1944 and it is ridiculous to discuss "distributions of partnership assets *in kind*" (emphasis added). Certainly any sort of a distribution of assets *in kind,* as and between two partners each owning an equal undivided one-half interest in valuable real properties, would contemplate some sort of equality as to the assets distributed. Here Yaeger grabbed all the marbles. She grabbed both the burdens and benefits of ownership. She also expressed a protective interest in Heber's security and medical care and stated that she wanted her to have "an income for life". Petitioner Heber's wishes and intentions are of no importance since this determination was purely an expression of the will of Yaeger. To characterize this as a "distribution of assets in kind" is patently absurd.

The Tax Court was put to the clear duty of (1) determining the fair market value on August 10, 1944 of the life income according to annuity valuation precedents

(see a discussion of the valuation of life incomes and life estates, Merten's Law of Federal Income Taxation, Volume 3 A, §21:26); *or* (2) deciding that the fair market value of Petitioner Heber's income for life was not determinable as of August 10, 1944 and that the only appropriate method for reporting her capital gain would be on the installment basis measurable by actual payments received and reported from year to year. The Tax Court, with the cost to both Petitioner Heber and Yaeger of their ownership interests available and uncontested, wholly ignored the disproportionate values in the hands of the respective parties after August 10, 1944; i.e. Petitioner Heber had an income for life but Yaeger had an equal income for life *plus* outright ownership of all the properties. The significance of this fact cannot be ignored or characterized as a "reshuffling of their interests in the partnership properties". *This is the essence or ultimate point which the Tax Court bypassed and left undecided.*

The Tax Court ignores those cases which have held that the transfer of a life estate in a capital asset results in capital gain or loss. In *Bell's Estate vs. Commr.*, 137 F2d 454 (C.A. 8 1943), the Court held that where life beneficiaries of a trust transferred their interest to the remainderman, in consideration of cash and securities, the amounts received constituted proceeds of sales of capital assets and not, as the Commissioner contended, ordinary income. Similar conclusions were reached in *McAllister vs. Commr.*, 157 F2d 235 (C.A. 2 1946) and *Estate of Camden vs. Commr.*, 139 F2d 267 (C.A. 6 1943). The above cases are somewhat the reverse of the

facts presented here on Appeal, since in those cases the life tenant surrendered to the remainderman his right to receive income in exchange for a present cash consideration or other thing of value. This was held to result in a capital gain to the life tenant or beneficiary of a trust on the theory that under the decision of *Blair vs. Commr.*, 300 U.S. 5 (1937), assignments of life interests in these instances constituted transfers of an interest in the trust assets rather than a mere assignment of the naked right to income. In the instant case, and as apparently decided in *Steeve vs. Yaeger* (supra), there was a wholly disproportionate surrendering of title to the properties themselves in exchange for a life estate in income. If this constituted a sale or exchange under the above authorities, certainly it would constitute a sale or exchange in our case. *To accept the Tax Court's superficial decision would be to ignore the cost or basis of capital assets in the hands of the respective parties, both before and after the taxable incident, and to assume that there was a simple "reshuffling" of the same assets with no taxable significance and with the tax burden upon income to be equally borne by the respective parties, in spite of the wholly unequal position of the respective parties after the "bargain".*

CONCLUSION.

The Tax Court's Findings of Fact and Opinion are without support, either in the applicable and appropriate law or in logic, if this case be without precedent; and its Findings of Fact and Opinion wholly fail to make necessary determinations in order to properly define and allocate the tax burdens involved in these Appeals.

Therefore, it is respectfully submitted that the Tax Court's Decision, as based upon its Findings of Fact and Opinion, is erroneous, and it is respectfully urged that the same be reversed or remanded.

Dated: August 27, 1965.

Respectfully submitted,

F. EDWARD LITTLE
Counsel for Petitioner and Appellant.

CERTIFICATE.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion the foregoing brief is in full compliance with those rules.

F. EDWARD LITTLE